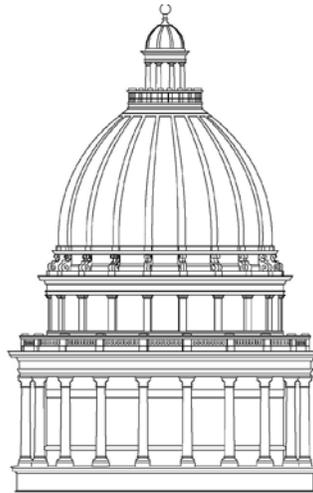


REPORT TO THE
UTAH LEGISLATURE

Number 2013-05



**A Performance Audit
Of Higher Education's Competition With
The Private Sector**

July 2013

Office of the
LEGISLATIVE AUDITOR GENERAL
State of Utah



STATE OF UTAH

Office of the Legislative Auditor General

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JOHN M. SCHAFF, CIA
AUDITOR GENERAL

July 08, 2013

TO: THE UTAH STATE LEGISLATURE

Transmitted herewith is our report, **A Performance Audit of Higher Education's Competition with the Private Sector** (Report #2013-5). A digest is found on the blue pages located at the front of the report. The audit scope and objectives are explained at the close of the Introduction.

We will be happy to meet with appropriate legislative committees, individual legislators, and other state officials to discuss any item contained in the report in order to facilitate the implementation of the recommendations.

Sincerely,

A handwritten signature in black ink that reads "John M. Schaff". The signature is stylized and cursive.

John M. Schaff, CIA
Auditor General

JMS/lm

Digest of A Performance Audit of Higher Education's Competition With The Private Sector

State institutions of higher education provide many goods and services to their campus communities. However, when these institutions sell goods and services to individuals outside their campus communities, they encroach on businesses in the private sector. These sales raise concerns because institutions of higher education have advantages over private businesses. Our review indicates that higher education business enterprises are increasingly encroaching on the private sector.

Off-Campus Red Zone Stores Compete with Private Businesses in Violation of Policy. The University of Utah's off-campus Red Zone stores are competing with private businesses and encroaching into the private market. We believe these stores violate Board of Regents policy R555 and University of Utah policy 3-150, which regulate competition with the private sector. They are violating both policies by providing services that are not incidental to normal operations as well as advertising to the general public.

The Red Zone stores function as departments of the University of Utah campus bookstore. The stores sell University of Utah licensed insignia merchandise similar to that available from private retailers. Beginning in 2010, the campus bookstore began to gradually expand the Red Zone along the Wasatch Front. Four Red Zone locations currently exist, with three being housed in off-campus shopping centers in Sandy, Layton, and West Jordan. In FY 2012, the off-campus Red Zone stores had combined sales of \$1.9 million.

Some On-Campus Enterprises Compete with the Private Sector. Several on-campus auxiliary enterprises compete to some extent with the private sector. For example, the University of Utah and Utah State University have on-campus hotels and conference centers that attract business from the public. While not as great a concern as the off-campus Red Zone stores, the on-campus enterprises also are required to avoid directly marketing or providing extensive services to the general public.

Chapter I: Introduction

Chapter II: Higher Education Businesses Are Encroaching on the Private Sector

Chapter III: Sales Tax Practices Are Inconsistent

Policy Makers Should Address University Competition with Private Businesses. Both the Legislature and the Board of Regents should consider clarifying state policy concerning higher education institutions' competition with private businesses. Unlike some other states, Utah statute does not address higher education competition with the private sector. While the Board of Regents has a policy on competition, we believe it is outdated and unenforced. We think policy makers should consider providing additional guidance on how far institutions may encroach on private businesses.

Policymakers Should Address Ramifications of Evolving Sales Tax Practices. The Legislature should consider clarifying sales tax policy on sales transactions by colleges and universities. Clarification could include specifying the scope of the exemption with regard both to eligible items and to eligible purchasers for tax-exempt sales. Currently, all state institutions sell textbooks tax free but their computer sales practices are inconsistent. Weber State University does not charge sales tax on computers sold to students, but other state institutions do. The Board of Regents could also encourage consistency by providing guidance concerning "educationally-related materials" and "unrelated business activities."

Because current tax law in this area is general and open to interpretation, the Legislature should consider clarifying tax policy. A Tax Commission official told us that one could argue that anything that colleges and universities sell could be tax exempt. Therefore, the Legislature should consider addressing not only what items that should be sales tax exempt but also what type of purchasers should receive exemptions. We think a key factor the Legislature should consider is the impact exempt sales may have on private business.

Campus Bookstores Do Not Sell Academically-Priced Computers to the Public. Neither Weber State University nor other college and university bookstores appear to be selling academically-priced Apple computers to the public. We tested five bookstores and found they do not sell Apple computer to the general public. We also confirmed that bookstores not tested have policies designed to prevent the sale of Apple computers to the general public.

REPORT TO THE
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Report No. 2013-05

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Of Higher Education's Competition With
The Private Sector**

July 2013

Audit Performed By:

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Chapter I

Introduction

State institutions of higher education provide many goods and services to their campus communities. However, when these institutions sell goods and services to individuals outside their campus communities, they encroach on businesses in the private sector. These sales raise concerns because institutions of higher education have advantages over private businesses. Our review indicates that higher education business enterprises are increasingly encroaching on the private sector.

Auxiliary Enterprises Provide Services To Campus Communities

State colleges and universities often provide on-campus services through institution--owned and --operated entities known as auxiliary enterprises. Utah Board of Regents policy R550 defines auxiliary enterprises as “business enterprises or other support activities . . . the primary purpose of which is to provide specified services to students, faculty, staff or guests of the institution.” Auxiliary enterprises are expected to operate in a businesslike manner and charge customers at a level that enables them to be “essentially self-supporting.” Historically, auxiliary enterprises include some of the following: campus bookstores, campus newspapers, campus dining facilities, and student housing.

The Utah Board of Regents established a policy to place limitations on the extent of competition with the private sector allowed by state institutions of higher education. This policy is known as Board of Regents policy R555, “Providing facilities, goods and services in competition with private enterprise.” This policy, shown in Appendix A, allows for only limited sales to the public (for example, occasional sales by the campus bookstores or food services to campus visitors). The policy also prohibits advertising to the general public.

Board of Regent policy R555 provides guidelines limiting competition with the private sector.

University Auxiliary Enterprises Have Advantages over Private Businesses

Business enterprises operated by colleges and universities have advantages over private businesses, making direct competition concerning to some in the private sector. For example, auxiliary enterprises may operate in taxpayer-supported facilities and often benefit from the Internal Revenue Code Section 501(c)(3) charitable organization tax status of their colleges and universities. Organizations with 501(c)(3) status receive exemptions from certain taxes, such as property, income, and sales taxes. Private businesses generally do not have these tax advantages.

Most Utah colleges and universities have 501(c)(3) status that provides them tax advantages.

While generally tax exempt, colleges and universities are subject to the Unrelated Business Income Tax (UBIT), which is collected by the Internal Revenue Service (IRS). Organizations with 501(c)(3) status, including colleges and universities, are required to pay taxes on income from any trade or business regularly conducted and not substantially related to its exempt purpose. The income generated by these unrelated business activities are subject to the UBIT tax. However, a recent IRS analysis found that colleges and universities across the country frequently underreport their unrelated business income by including unallowable expenses or incorrectly classifying which enterprises are subject to UBIT.

In addition, auxiliary enterprises are not required to be completely self-supporting. Board of Regents policy R550, shown in Appendix B, allows state colleges and universities to subsidize auxiliary enterprises if these activities cannot reach a “total self-support level.” Private businesses often do not have the same luxury and go out of business when they cannot cover their losses.

Audit Scope and Objectives

We were asked to determine whether some business activities of institutions of higher education unfairly competed with private business. We reviewed various state college and university auxiliary enterprises that seemed to be going beyond their traditional roles and competing with the private sector in possible violation of Board of

Regents policy R555. The auxiliary enterprises or operations we reviewed include the following:

- Red Zone retail stores, Rice-Eccles Stadium, University Guest House and Conference Center (University of Utah)
- University Inn and Conference Center (Utah State University)

In addition, we reviewed concerns that Weber State University was not charging sales tax on computer purchases and was inappropriately selling Apple computers to the public. We visited five different colleges and universities and reviewed their policies and procedures for selling educationally-priced Apple computers.

Specifically, our audit objectives were the following:

1. Determine whether institutions of higher education are in compliance with Board of Regents policy R555 and if they provide facilities, goods, and services in competition with private enterprise
2. Determine if institutions of higher education appropriately charge sales tax on computer sales and offer academic discounts on computers sold to the public.

Chapter II focuses on our concerns with the Red Zone retail stores and their compliance with the Utah Board of Regents policy R555 as well as with other auxiliary enterprises that may compete with private businesses. Chapter III discusses Weber State University's practice of not charging sales tax on computer purchases made by students and also colleges' and universities' practices of selling academically-discounted Apple computers to nonstudents.

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Chapter II

Higher Education Businesses Are Encroaching on the Private Sector

The Legislature should consider providing policy guidance addressing higher education competition with private businesses. We believe the University of Utah’s off-campus Red Zone retail stores highlight an increasing encroachment by universities into the private market in violation of Board of Regents and University of Utah policies. Some on-campus business activities also raise concerns because state colleges and universities provide services to the general public in competition with the private sector. The Board of Regents should update its policy addressing private sector competition and provide better oversight and enforcement of the policy.

Auxiliary enterprises on higher education campuses provide important services to campus communities in furtherance of institutional missions. However, auxiliary enterprises are restricted from competing with private businesses. Board of Regents policy states that “Services provided by auxiliary enterprises may be incidentally available to members of the general public but are not to be marketed to the general public or outside organizations” This chapter identifies various instances of higher education institutions marketing to the general public and recommends both that the Legislature consider providing policy guidance and that the Board of Regents provides oversight and enforcement of their policies.

Off-Campus Red Zone Stores Compete with Private Businesses in Violation of Policy

The University of Utah’s off-campus Red Zone stores are competing with private businesses and encroaching into the private market. We believe these stores violate Board of Regents policy R555 and University of Utah policy 3-150, which regulate competition with the private sector.

The Red Zone stores function as departments of the University of Utah campus bookstore. The stores sell University of Utah licensed insignia merchandise similar to that available from private retailers.

Off-campus Red Zone stores are in violation of both university and Board of Regent policy.

There are three Red Zone stores located off-campus.

However, the Red Zone stores carry a wider variety of products than is available from other retailers. Initially, the Red Zone was only found in the main campus bookstore. Beginning in 2010, the campus bookstore began to gradually expand the Red Zone along the Wasatch Front. Four Red Zone locations currently exist, with three being housed in off-campus shopping centers in Sandy, Layton, and West Jordan.

Both the Board of Regents and the University of Utah have established policies limiting competition with the private sector. These policies help to ensure that higher education does not have an unfair advantage over private businesses. Advantages may stem from many factors, including the ability to draw on institutional resources and tax advantages. Figure 2.1 shows part of the university policy.

Figure 2.1 Selected Provisions of University of Utah’s Policy 3-150: Auxiliary Enterprises Operation. The policy provides guidance to the university’s auxiliary enterprises concerning competition with private businesses.

The University of Utah has policy that prohibits their auxiliary enterprises from advertising to the general public.

Competition with Private Enterprise.

1. Auxiliaries shall not provide services to the general public, except if that service is incidental to the ordinary and authorized function of the auxiliary.
2. Auxiliaries shall not advertise their services to the general public.
3. All auxiliaries will conduct their activities consistent with State Board of Regents policy no. R555.

Source: University of Utah

The Board of Regents policy R555 has similar limitations on providing services outside the campus community except on an incidental basis and prohibits advertising to the general public unless an exception is specifically authorized by the board. As discussed below, we believe the off-campus Red Zone retail stores violate the policy limitations.

Off-Campus Red Zone Stores Are Not Incidental to the Ordinary and Authorized Function of a Campus Entity

The Red Zone stores that are located off-campus go beyond University of Utah policy 3-150 as well as Board of Regents policy R555 (shown in Appendix A). The policy states that auxiliaries cannot provide services to the general public unless “the service is incidental to the ordinary and authorized function of a campus entity....”

Although on-campus sales of merchandise can be considered incidental to normal operations, we do not think off-campus stores in local shopping centers qualify as incidental.

In fact, the university recognizes that the Red Zone stores are not directly related to the university’s mission by categorizing them as an unrelated business enterprise under federal regulations. While theoretically subject to unrelated business income taxes (UBIT), in practice no income taxes are paid.

Off-Campus Sales Are Significant. In the case of the campus bookstore, the policy allows for the occasional sale of merchandise to the general public. However, the campus bookstore essentially ensures sales are frequently made to the general public by having its Red Zone stores located off-campus. The off-campus Red Zones are located in retail shopping centers and are readily accessible to the general public. Anyone can purchase merchandise from these locations.

Sales revenue at off-campus stores are increasing. Figure 2.2 shows the total net sales (excluding returns) for the off-campus Red Zone stores for the last three years. These sales totals demonstrate the potential sales revenue lost by private businesses from the presence of off-campus Red Zone stores.

Figure 2.2 Total Net Sales of Red Zone Off-Campus Stores from July 2010 to May 2013. Revenues have increased over the past three years. (Note that only 11 months of data were available for the most recent year.)

Location	FY 2011	FY 2012	FY 2013 (11 months)
Sandy	\$810,590	\$1,454,118	\$1,026,062
Layton	0	429,384	369,052
West Jordan	0	0	540,938
Total	\$810,590	\$1,883,502	\$1,936,052

Source: University of Utah Campus Bookstore

The sales growth indicates an increasing encroachment by a higher education enterprise into the private sector.

Red Zone Stores Have Not Paid Income Tax. Despite the increasing sales revenues and apparent profitability, the university has not paid any income tax on the Red Zone stores. Colleges and

Off-campus Red Zone sales are significant.

Off-campus Red Zone sales revenue has increased each year.

universities calculate unrelated business income by totaling the income from all unrelated business activities and subtracting allowable deductions. Losses from these unrelated businesses activities can offset profits from other unrelated business activities. Since the University of Utah combines profits and losses from all of their unrelated business activities, just as a private sector taxpayer would do, it does not pay any unrelated business income taxes. Consequently, the University of Utah has not paid any income taxes on Red Zone store profits.

Red Zone Stores Should Not Advertise to the General Public

Similarly to private retail business, the Red Zone stores advertise to the general public. However, according to University of Utah policy 3-150 as well as Board of Regents policies R555 and R550, auxiliary enterprises must not advertise to the general public.

The off-campus Red Zone retail stores have been advertising in various media. These include cable television, radio, newspaper and other print, and the internet. Stores also conduct local advertising specific to their locations. For example, the Sandy Red Zone participates in local community events and sponsors a local high school football program. In short, a good portion of Red Zone advertising can be seen by a general audience beyond the campus community.

Figure 2.3 shows the amount spent on advertising by the off-campus Red Zone stores over the last three years. The total amount spent on advertising by the Red Zone Stores over the last 35 months is over \$93,000.

Figure 2.3 Advertising Expenses of the Red Zone Retail Stores. According to policy from the Board of Regents and University of Utah policies, auxiliary services are not to advertise to the general public.

Location	FY 2011	FY 2012	FY 2013 (11 months)
Sandy*	\$30,167	\$17,030	\$14,097
Layton**	0	11,825	7,598
West Jordan***	0	0	12,787
Total	\$30,167	\$28,855	\$34,482

*Opened November 1, 2010, ** Opened September 1, 2011, *** Opened August 15, 2012
Source: University of Utah

Off-campus Red Zone stores are advertising to the general public.

Off-campus Red Zone stores have spent over \$93,000 on advertising the past three years.

Red Zone Stores Were Not Granted an Exception To Board of Regents Policy R555

According to Board of Regents policy R555, all auxiliary enterprises must comply with the criteria outlined in policy unless an exception has been granted by the Board of Regents. Policy provides that the board may grant an exception “if it determines, upon consideration and weighing of the various interests and public policies pertinent to providing the facilities, goods or services in competition with private enterprise, that the public interest favoring an exception outweighs the interest favoring denial of an exception.”

The Board of Regents staff told us that the University of Utah never asked for an exception to policy R555 for its off-campus Red Zone stores. In fact, the Board of Regents staff does not recall any exception to this policy being granted or even requested.

Some On-Campus Enterprises Compete with the Private Sector

Several on-campus auxiliary enterprises compete to some extent with the private sector. While not as great a concern as the off-campus Red Zone stores, the on-campus enterprises also are required to avoid directly marketing or providing extensive services to the general public.

While there are other auxiliary enterprises (see Appendix C) that exist on state college and university campuses that could be in violation of Board of Regents policy R555, we limited our review to a select group. This section addresses lodging and conference services at the University of Utah and Utah State University. The business enterprises we reviewed include the following:

- Rice-Eccles Stadium (University of Utah)
- University Inn (Utah State University)
- University Conference Center (Utah State University)
- University Guest House and Conference Center (University of Utah)

Off-campus Red Zone stores were not granted an exception from Board of Regent Policy R555.

Several on-campus enterprises appear to violate policy by marketing services to the general public.

Each of the auxiliary enterprises mentioned above has its own purpose within its campus environment and provides important services to the campus community. However, to avoid direct competition with private businesses, these auxiliary enterprises must comply with Board of Regents policy R555 by:

- Not advertising to the general public
- Not providing goods and services to the general public beyond what is incidental to normal operations

University of Utah Rice-Eccles Stadium Is Competing with the Private Sector

The University of Utah's Rice-Eccles stadium appears to violate University of Utah and the Board of Regents policy by advertising to the general public and providing services to the public on a regular basis. In fiscal years 2011 and 2012 combined, over 400 events were held. Although less than half the events were affiliated with the university, most of the revenue was generated from affiliated events.

Stadium management categorizes events involving university departments and programs, clubs, fraternities, athletic teams, students, faculty, and staff as affiliated with the University of Utah. Conversely, the director categorizes private weddings and receptions, high school dances, corporate banquets and meetings, and holiday parties as events unaffiliated with the university.

**Rice-Eccles Stadium
advertises to the
general public which is
against both University
of Utah and Board of
Regents policy.**

Rice-Eccles Stadium Advertises Its Services to the General Public. The stadium's Event Services office uses various media to advertise its services to the general public, such as bridal websites, bridal and corporate magazines, television, and trade shows. During fiscal year 2011, the Event Services office spent \$14,514 on advertising, with \$8,490 of that amount being spent on advertising relating to weddings. This constitutes 59 percent of the stadium's total advertising expense for fiscal year 2011. In fiscal year 2012, the Event Services office spent \$4,645 on wedding and corporate event advertising, which constitutes 40 percent of the total advertising expense for that year.

Rice-Eccles Stadium Hosts Many Unaffiliated Groups. As previously mentioned, the stadium director defines events like private weddings and receptions, high school dances, corporate banquets and

meetings, and holiday parties as events unaffiliated with the university. Figure 2.4 shows the number of unaffiliated events hosted at the stadium during fiscal years 2011 and 2012.

Figure 2.4 Rice-Eccles Stadium Tower Events and Revenues— Events Affiliated and Unaffiliated with the University of Utah for Fiscal Years 2011 and 2012. Events that are not affiliated with the university increased 30 percent in one year.

	FY 2011		FY 2012	
	Count	Revenue	Count	Revenue
Affiliated Events	94	\$1,265,215	85	\$1,430,963
Unaffiliated Events*	105	313,825	136	533,751
Total Events	199	\$1,579,050	221	\$1,964,714

Source: University of Utah Stadium and Arena Event Services

*Note: High School Football events are classified as Unaffiliated Events by stadium management. In fiscal year 2011, three events were held generating \$41,926 in revenue. Five events were held in fiscal year 2012 generating \$42,860 in revenue.

According to information provided by University of Utah Stadium and Arena Event Services, the number of unaffiliated events hosted at the stadium increased by 30 percent from fiscal year 2011 to fiscal year 2012. In addition, the revenues for unaffiliated events increased by roughly 70 percent during the same time period. The stadium holds numerous events to generate revenues in order to cover its costs. If unaffiliated groups were not served, the facility would sit idle more frequently.

We compared the amounts reported to us and shown in Figure 2.4 with information used in the university’s unrelated business income tax (UBIT) calculation. While we noted some differences, it was beyond the scope of our review to reconcile them. However, both sources show that a significant amount of revenue is provided by events not directly related to the university’s mission.

Many of these unaffiliated events could have been housed in privately-owned event and reception centers. We believe the number of unaffiliated events and the amount of revenue generated by them demonstrates that the stadium is providing services that go beyond what is incidental to its ordinary operations. Given the increase in the number of events and revenue generated between 2011 and 2012, these activities are increasingly encroaching into the private sector.

Revenue from unaffiliated events at the stadium increased \$219,926 from fiscal year 2011 to 2012.

Utah State's University Inn and Conference Center Are Competing with the Private Sector

Utah State University's University Inn and its Conference Center also appear to be violating Board of Regents policy by advertising to the general public and providing services to the public on a regular basis.

The University Inn Advertises Its Services to the General Public. The University Inn has provided on-campus lodging at Utah State University since 1981. The inn's management uses multiple media for advertising, including local newspapers, magazines, websites, and phonebooks. Advertising expenses were \$6,801 in fiscal year 2011 and \$4,586 in fiscal year 2012. Some of the advertising targets outdoor enthusiasts and tourists from outside Cache Valley and outside the campus community.

The University Inn advertises to the general public.

University Inn Provides Lodging to the General Public. We did not analyze guest records from the inn. However, we spoke with the management of Logan-area hotels who told us the inn affects their hotels' business. A few hotels indicated the inn's presence negatively affects their business. Management of these hotels voiced concerns that the inn is subsidized, allowing it to provide lower rates. They believe they have lost valuable lodging bids to the inn because it can provide these lower rates. However, university officials claim that the inn is not subsidized.

Utah State University Conference Center Advertises Its Services to the General Public. The conference center, located on the campus of Utah State University, uses various media to advertise its services to the general public, such as newspapers, magazines, internet sites, and newsletters. The conference center had \$4,012 in advertising expenses in fiscal year 2011 and \$4,238 in fiscal year 2012. Some of the advertising targets outdoor enthusiast groups, tourists, youth groups, and corporate groups outside the campus community. By advertising to the general public, it appears the conference center is competing with local businesses.

Utah State University Conference Center Hosts Many Unaffiliated Groups. Figure 2.5 shows the number of events held at the conference center in fiscal years 2011 and 2012 and the amount of revenue generated. While unaffiliated events help the conference center

meet its costs, they accounted for only seven percent of total revenues in fiscal year 2012.

Figure 2.5 Utah State Conference Center Events for Fiscal Years 2011 and 2012 Involving Affiliated and Unaffiliated Groups.

	FY 2011		FY 2012	
	Count	Revenue	Count	Revenue
Affiliated Events	275	\$3,139,848	375	\$3,544,389
Unaffiliated Events	65	289,854	81	260,662
Total Events	340	\$3,429,702	456	\$3,805,051

Source: Utah State University Conference center

The conference center staff categorizes events such as church youth group conferences, university departments and education programs, club and fraternity functions, youth sports camps, and the summer citizen program as affiliated with the university. Conversely, the conference center staff considers private weddings and receptions, high school graduations, tourism conferences, corporate banquets and meetings, and pageants as unaffiliated with the university.

The University of Utah Guest House and Conference Center Is Competing with the Private Sector

The University of Utah’s Guest House and Conference Center (Guest House) advertises and provide services to the general public in apparent violation of Board of Regents policy.

The University Guest House and Conference Center Advertises Its Services to the General Public. The Guest House marketing expenses were \$22,378 in fiscal year 2011 and \$40,824 in fiscal year 2012. About half of the marketing expenses were reported as unrelated to the university’s charitable purpose. The Guest House manager uses various media for off-campus advertising, such as business and wedding magazines and trade shows.

Some University Guest House and Conference Center Activities Are Unrelated to the Campus Community. Some of the Guest House’s business activities do not appear to be incidental to its ordinary operations. For example, the Guest House rents rooms and hosts private weddings, parties, and corporate functions unrelated to the campus community.

The Conference Center hosts many groups that are not affiliated with Utah State University.

The Guest House advertises to the public and has activities unrelated to the campus community.

In their unrelated business income tax (UBIT) calculation, the university reported over \$1.5 million of revenue from the Guest House each of the last two years, with room rentals accounting for most of the revenue. Room rentals to campus departments and those related to hospital stays are not included in that amount because they are related to the university's charitable purpose. However, other room rentals are included. In fiscal year 2012, about 40 percent of all Guest House room rental revenue was included in UBIT.

Policy Makers Should Address University Competition with Private Businesses

Both the Legislature and the Board of Regents should consider clarifying state policy concerning higher education institutions' competition with private businesses. Unlike some other states, Utah statute does not address higher education competition with the private sector. While the Board of Regents has a policy on competition, we believe it is outdated and unenforced. We think policy makers should consider providing additional guidance on how far institutions may encroach on private businesses.

The Legislature Should Consider Providing Policy Guidance on Private Sector Competition

The State of Utah has not enacted statute that addresses higher education competing with the private sector. In contrast, we found statutes in Arizona, Colorado, Washington, and Iowa that address the topic. These statutes place restrictions on who can purchase goods and services from colleges and universities. However, even with the statutory restriction, some of these states have institutions that conduct off-campus sales.

Neighboring States Have Enacted Laws that Limit Higher Education Competition with the Private Sector. Both Arizona and Colorado have statutes that limit higher education's competition with the private sector. In both cases the language is similar to that contained in the Utah Board of Regents policy R-555. For example, Arizona Statute 41-2753(A)(1) states:

Several states have statutes that address higher education's competition with the private sector.

Community colleges and universities under the jurisdiction of a governing board shall not, unless specifically authorized by statute: Provide to persons other than students, faculty, staff and invited guests goods, services or facilities that are practically available from private enterprise, unless the provision of the goods, service or facility offers a valuable educational or research experience for students as a part of their education or fulfills the public service mission of the community college or university. This paragraph does not apply to sponsoring or providing facilities for recreational, cultural and athletic events or to facilities providing food services and sales.

Colorado law is very similar to the Arizona law shown above. In essence, these laws prohibit colleges and universities from providing goods and services to the general public unless doing so gives students an educational or research experience or meets the institution's public service mission.

Despite these laws, it appears that Arizona and Colorado have institutions of higher education with off-campus enterprises similar to the Utah Red Zone stores. For example, we understand that both the University of Arizona and Colorado State University either have or are planning off-campus stores that sell insignia merchandise. It was beyond the scope of our review to determine the conditions under which these off-campus enterprises are allowed.

If the Utah Legislature wants to discourage higher education institutions from establishing unrelated business enterprises that compete with private businesses, it should consider providing statutory guidance. Even though Board of Regents policy already addresses competition with the private sector, it does not seem to be effective. Thus, additional legislative guidance seems appropriate.

Board of Regents Needs to Improve Enforcement And Oversight of Policy R555

Regardless of whether the Legislature acts, we think the Board of Regents needs to improve enforcement and oversight of its policy limiting private sector competition. The fact that the Red Zone stores have been in business for the last three years shows a lack of oversight and enforcement by the Board of Regents. In addition, the Board of

Regents should review and consider updating the policy, which has not been amended in many years. By clarifying policy and providing better oversight, the Board of Regents can prevent unwarranted competition with the private sector.

Board of Regents needs to improve its oversight and enforcement of policy R555.

Board of Regents Needs to Improve Policy Oversight and Enforcement. The Board of Regents needs to improve its enforcement and oversight of policy R555 as business activities of institutions of higher education have gradually encroached on the private sector. As previously illustrated, both the off-campus Red Zone stores and a number of on-campus business enterprises routinely advertise and provide goods and services to the general public. The Board of Regents needs to better monitor the institutions of higher education to ensure compliance with policy R555.

The Board of Regents can improve oversight and enforcement of its policy by directing audit staff to monitor higher institutions' compliance with policy R555. Likewise, college and university administrators or internal auditors could be directed to annually report on policy compliance.

The Board of Regents Also Needs to Improve and Update Policy R555. The Board of Regents needs to improve policy R555 in order to prevent higher education institutions' unauthorized competition with the private sector.

One way the Board of Regents could improve policy R555 is by including a grievance process. This process would allow private individuals or businesses to submit complaints against colleges or universities who may be directly competing with the private sector. We found that Arizona, Colorado, and Iowa Boards of Regents have included a grievance process in their policies that deals with higher education competition with the private sector.

Board of Regents needs to address college enterprises that operate off-campus.

The Utah Board of Regents also needs to update its policies to address higher education business enterprises that function off-campus. The current language or intent of policy R555 is directed towards on-campus business enterprises. The policy does not account for business enterprises located off-campus. The University of Utah believes that, since policy R555 does not specifically address off-campus business enterprises, the university is allowed to operate them.

The Board of Regents needs to update policy R555 to include guidelines to address higher education's business enterprises operating off-campus.

Recommendations

1. We recommend that the Legislature consider providing statutory policy guidance that addresses higher education competition with the private sector.
2. We recommend that the Board of Regents provide greater oversight and enforcement of its policy pertaining to institutions of higher education competition with the private sector.
3. We recommend that the Board of Regents update policy R555: Providing Facilities, Goods and Services in Competition with Private Enterprise.

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Chapter III Sales Tax Practices Are Inconsistent

The Legislature should consider clarifying sales tax policy on sales transactions by colleges and universities. Clarification could include specifying the scope of the exemption with regard both to eligible items and to eligible purchasers for tax-exempt sales. The Board of Regents could also encourage consistency by providing guidance concerning “educationally-related materials” and “unrelated business activities.”

Currently, all state institutions sell textbooks tax free but their computer sales practices are inconsistent. Weber State University (WSU) recently stopped charging sales tax on computers sold to students, but other institutions still collect the tax. In the future, sales tax exemptions could be applied more broadly. For example, based on its 501(c)(3) status, Brigham Young University sells most items from their bookstore tax free to students, faculty, and staff.

Utah State Tax Commission officials told us that WSU does not need to collect tax on sales of items directly related to its 501(c)(3) status. It is not clear what items (other than textbooks) should be exempt from sales tax, but a Tax Commission official told us that mission-based activities could arguably be interpreted very broadly, making many items sold by institutions tax exempt. However, a broad interpretation of tax-exempt sales would reduce institutions’ sales tax remittances and place private sector merchants at a competitive disadvantage.

We reviewed the sales tax issue because of an allegation, raised by an Ogden area business, that the WSU bookstore was selling academically-priced Apple computers to the general public and not charging sales tax. The individual claimed the WSU bookstore practices placed private businesses at an unfair competitive disadvantage. Our review did not identify any instances of selling academically-priced Apple computers to the general public, but did

Unlike other state institutions, WSU does not charge sales tax on computers sold to students.

confirm that WSU does not charge sales tax on sales of computers to students.

Policymakers Should Address Ramifications of Evolving Sales Tax Practices

Because sales tax practices at higher education institutions appear to be changing, it is a good time for the Legislature to review desired policy. Tax Commission officials told us that WSU's practice of not charging sales tax on computers sold to students was appropriate. Based on that, other institutions could soon follow suit. However, according to Tax Commission officials, it is not clear whether other items or whether sales to non-students could also be considered tax exempt.

The Tax Commission confirmed that WSU's practice of not charging sales tax on computers sold to students is appropriate.

Policymakers should consider clarifying the boundaries of tax-exempt status for items sold by colleges and universities. Because institutional missions are broadly defined to include teaching, research, and public service and because virtually all activities are viewed to be in furtherance of that mission, there are no clear limits.

WSU Does Not Need to Charge Tax On Computer Sales to Students

Tax Commission officials confirmed to us that, under existing tax law, WSU may sell computers to students tax free. *Utah Code* sections 59-12-104(8) and 59-12-104.1(1) exempt sales made by religious and charitable organization from sales and use tax as long as "the sale is made in the conduct of the institution's or organization's regular religious or charitable functions or activities." *Utah Administrative Rule* R865-19S-43 indicates religious or charitable organizations seeking an exemption from sales tax must have 501(c)(3) status from the Internal Revenue Service (IRS).

In 2008, the Tax Commission issued a ruling to the University of Utah addressing tax on textbook sales. The ruling stated, "If a state university receives a Section 501(c)(3) designation from the IRS and the sale of textbooks is part of its regular religious or charitable functions and activities, the sale qualifies for the exemption." WSU has applied the same logic to computer sales.

WSU Considers Computers to Be Instructional Materials Similar to Textbooks. According to WSU officials, sales tax for computer purchases has not been charged to current and entering Weber State students since January 2010. They told us computers are considered required instructional materials similarly to textbooks because computers are often required for class. Up to now, other state colleges and universities in Utah have charged sales tax on items from their bookstores except for textbooks and other course-related material.

The Tax Commission recently conducted a sales tax audit and concluded that WSU's practice of not charging sales taxes on computers sold to students was within the university's educational and charitable function. A Tax Commission official told us that arguably, the sales tax exemption could be interpreted to include faculty and staff and even the general public. However, the sales tax audit only addressed existing practices.

Sales Tax Practices Affect Both Tax Collections and Private Sector Competitiveness. Sales tax collections are an important source of revenue to the state and local governments that is affected by tax exemptions. Figure 3.1 illustrates the estimated sales tax revenue impact at two universities under the scenario of both universities charging sales tax on computers and educational software sold to students. In 2012, the University of Utah collected sales tax on these sales, but WSU did not.

Figure 3.1 Estimated Sales Tax Revenue Assuming Both Universities Charged Tax on Computers and Educational Software.

These estimated tax totals are for fiscal year 2012 for two public institutions.

School	FY 2012
Weber State University	\$167,353
University of Utah	235,291
Total	\$402,644

Source: Data provided by Weber State University and University of Utah (an estimate)

Although we did not collect data from other public or private institutions, the issue may affect their sales as well. Thus, the annual statewide impact could be far more than the \$400,000 amount shown in Figure 3.1. We believe the state could lose on average \$1.16 million

WSU has not charged sales tax on computers sold to students since January 2010.

Sales tax collections will decrease if other state colleges and universities follow WSU's example.

Private businesses could be at a competitive disadvantage if state institutions do not charge sales tax on computers.

per year if all state institutions follow Weber State and stop charging sales tax on computers and other items at the bookstores. Of course this number could be much higher if state institutions are allowed to sell all items in their books stores tax free to students, faculty, and staff.

While the trade-off between student tax savings and government tax losses is important, the impact on private business may be more so. As mentioned, we reviewed this issue because of a complaint from an Ogden-area business that WSU's tax exemption for sales of computers and software placed them at an unfair competitive disadvantage. While WSU has now limited the tax exemption to students, as discussed in the next section, it could potentially be broadened in the future. Moreover, WSU plans to open another bookstore on a satellite campus in downtown Ogden. The downtown location could make the concerns about unfair competition more pronounced.

Definition of Tax Exemptions Could Be Broadened in the Future

As mentioned above, a Tax Commission official told us that while their sales tax audit only looked at WSU's existing practices, a broader interpretation of exempt transactions could be argued. Existing state tax policy relies on a federal IRS 501(c)(3) designation which could potentially be applied very broadly.

State tax policy relies on a federal IRS 501(c)(3) designation which could be applied very broadly.

For example, Brigham Young University (BYU), which is a private university with the 501(c)(3) designation does not charge sales tax to students, faculty, and staff on most items in their bookstore. Thus, while WSU limits the exemption more narrowly to textbooks and computer related items, BYU extends the exemption to other items, including logo wear and non-restaurant food items. Similarly, while WSU limits exemptions to purchases by current students, BYU extends the exemption to faculty and staff as well.

WSU Does Not Have a Clear Method to Decide Which Transactions Are Exempt from Sales Tax. WSU does not charge sales tax on the following items sold to eligible students: computers, calculators, flash drives, iPads, and required course material packets. However, course supplies such as paper, pencils, and binders are taxed. WSU officials explained that computers and other technology items are expensive and not charging sales tax on these items helps students.

WSU exempts certain technology items but charges tax on other school supplies.

While it seems that WSU could expand its definition of tax-exempt sales more broadly, it is not clear how much. According to Tax Commission officials, the sale of any item considered to be within the university's regular charitable functions and activities may be exempt.

Universities' Regular Functions and Activities Can Be Broadly Construed. Universities have a great breadth of functions and activities that support their mission of education, research, and public service. Certainly the outreach activities of higher education institutions greatly enrich local communities.

However, in discussing sales tax issues with Tax Commission officials, they would not define what boundaries exist for tax exempt sales. They believe it should be the role of the Legislature or the Board of Regents to provide statute or policy that would establish boundaries for tax exempt sales. This would create consistency among state colleges and universities.

By definition, perhaps all institutional functions and activities further their missions. For example, university officials told us that the first and foremost priority of the off-campus Red Zone stores is to support the mission of the University of Utah. While no one suggested the stores should not collect sales tax, such a claim could be possible. Federal regulations may not provide adequate guidance.

Federal Standards Appear to Be Inconsistently Applied by Universities. Chapters I and II noted that 501(c)(3) organizations, including universities, are required to pay unrelated business income taxes (UBIT). The IRS defines unrelated business income as income from any trade or business regularly conducted and not substantially related to its exempt purpose.

Designating a trade or business unrelated could provide a basis for determining sales tax exemptions if the designation were consistently and properly applied. In fact, *Utah Administrative Rule* R865-19S-43 adopts the federal definition and requires that "Religious and charitable institutions must collect sales tax on any sales income arising from unrelated trades and businesses." However, inconsistent applications of UBIT standards make them unreliable for state purposes. Nationwide, the IRS has discovered that many institutions

State institutions' interpretation of UBIT is inconsistent.

improperly classify their unrelated business activities. Mistakes are made both in activities included and excluded.

Our review of two universities' practices found inconsistencies. For example, one of the universities included the public lodging and conference services described in Chapter II, but the other university did not. A university official told us that their lodging and conference center activities are considered an integral part of the university mission. Another issue is that, according to the Federal tax code, organizations can only deduct expenses that are directly related to the unrelated business activities. We are concerned that universities may be applying indirect overhead charges incorrectly.

The Legislature Should Consider Addressing Tax Policy Issues

Because current tax law in this area is general and open to interpretation, the Legislature should consider clarifying tax policy. A Tax Commission official told us that one could argue that anything that colleges and universities sell could be tax exempt. Therefore, the Legislature should consider addressing not only what items should be sales tax exempt but also what type of purchasers should receive exemptions. We think a key factor the Legislature should consider is the impact exempt sales may have on private business.

What Items Are Eligible for Tax Exemptions? In recent years, state colleges and universities have increased the number of items eligible for sales tax exemptions. In 2008, the Tax Commission ruled that textbooks qualified for exemption and now has concluded that computers are also eligible. It is not clear what other items may qualify as well. Exemptions could be limited to certain instructional materials or defined more broadly.

What Purchasers Are Eligible for Tax Exemptions? Our understanding is that WSU and other institutions now limit tax-free purchases to students only. But, depending on what items other than textbooks qualify, the issue becomes more relevant. We have documented one instance where WSU sold an iPad to a non-student without collecting sales tax.

Policy Impact on the Private Sector Should Be Considered. Any broadening of tax-free sales by colleges and universities negatively

In 2008, textbooks sold to college students were determined to be exempt from sales tax.

Eligibility requirements for sales tax exemptions need to be clarified.

affects the private sector. Private businesses that sell similar items are at a competitive disadvantage. If institutions expand locations, such as the planned downtown Ogden location of the WSU bookstore, private merchants will be increasingly impacted.

Board of Regents Could Provide Additional Guidance To Address Institutional Inconsistencies

Independent of any legislative action, the Board of Regents could address institutional inconsistencies by providing guidance. Much of the discussion we had with WSU officials centered on what items should be considered “instructional materials.” If sales tax exemptions are to be limited to instructional materials sold to students, a clear definition would help provide consistency.

A second area of inconsistency involves institutional classification of unrelated business activities. Trades or businesses that are not related to a university’s exempt purpose are a prime area of concern for potential unwarranted encroachment on private businesses. As was discussed in Chapter II, higher education competition with private enterprise is addressed by Board of Regent policy R555. Currently, institutions appear to be inconsistent in their own assessment of what constitutes unrelated business activities.

Campus Bookstores Appear Not To Be Selling Academically-Priced Computers to the Public

Neither Weber State University’s nor other colleges’ and universities’ bookstores appear to be selling academically-priced Apple computers to the public. We tested five bookstores and found they do not sell Apple computers to the general public. We also confirmed that bookstores not tested have policies designed to prevent the sale of Apple computers to the general public.

We reviewed this area because of a concern that the WSU bookstore was selling academically-priced computers tax-free to the public, thereby placing private sector businesses at a competitive disadvantage. Unlike the sales tax issue that was discussed earlier, we did not find any merit to the concern that the general public could buy academically-priced computers at campus bookstores.

Testing revealed that state colleges and universities were not selling academically priced computers to the general public.

Limited Testing Indicates Bookstores Appropriately Screen Apple Computer Buyers

We visited five state college and university campus bookstores and tried to purchase Apple computers. In each instance, bookstore employees asked us to provide some form of school identification such as a school ID card or school ID number. When we could not provide school identification, bookstore employees would not sell us an Apple computer.

Management of these stores also confirmed that the sales protocols used by bookstore employees during our tests were consistent with their campus bookstore's policy. Store managers told us individuals wanting to purchase an Apple computer must provide valid school identification and complete an eligibility form. These bookstores are only allowed to sell Apple computers to students, faculty, and staff as stipulated in their private agreements with Apple.

All Campus Bookstores Appear to Appropriately Limit Apple Computer Sales

We contacted the management of three bookstores we were unable to visit and asked about their computer sales policies. Two of the three bookstores only sell Apple computers to the students, faculty, and staff of their respective institutions per their private agreements with Apple. The other bookstore does not sell computers.

State institutions have sufficient computer sales policies in place.

All bookstores that sell computers provided us with some form of written computer sales policy. The documentation provided was either excerpts from bookstore policy and procedure manuals, computer eligibility requirements listed on the bookstore's website, or forms given to customers to verify purchase eligibility. The documentation contained controls designed to prevent Apple computers from being sold to ineligible individuals.

Recommendations

1. We recommend that the Legislature consider clarifying sales tax policy related to sales by higher education institutions.

2. We recommend that the Board of Regents consider providing guidance concerning “educationally related materials” and “unrelated business activities.”

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Appendices

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Appendix A

R555, Providing Facilities, Goods and Services in Competition with Private Enterprise¹

R555-1. Purpose: To establish policy and guidelines on public colleges and universities providing facilities, goods and services in competition with the private sector.

R555-2. References

2.2. Utah Code §53B-7-101(9) (Each Institution Handles Financial Affairs Under General Supervision of the Board)

2.3. Policy and Procedures R510, Auxiliary Enterprises Operation and Accountability

R555-3. Definitions

3.1. **"Institutions"**: colleges and universities which are part of the Utah System of Higher Education.

3.2. **"Campus Community"**: an institution's students, faculty, staff, and campus guests.

3.3. **"Services"**: an institution's facilities, goods, and services.

R555-4. Policy: Institutions shall not sell or provide services to their campus community or to the general public except as set forth below.

4.1. Services Necessary for the Education of Students or Basic Research: Institutions are expected to provide their campus communities appropriate services which are necessary for the education of students, or the performance of basic research in accordance with the institution's mission as established by the Utah State Board of Regents. This responsibility includes, but is not limited to, instructional, research, and public service programs; libraries; computing programs; and other academic support services.

4.2. Educationally Related Activities: Institutions may provide other services to their campus communities even though such services are practically available elsewhere providing that the services satisfy reasonable educationally related needs of the campus community, e.g. campus newspapers, campus bookstore, campus dining facilities, student housing, etc., and provided such services are not advertised to the general public and are not generally provided to persons who are not members of the campus community.

4.3. Services to Persons Other Than Members of the Campus Community: An institution shall not provide services to persons other than members of the campus community unless:

¹ Adopted November 14, 1986, amended January 24, 1997

4.3.1. The service offers a substantial and valuable educational or research experience for registered students and faculty;

4.3.2. The service fulfills the institution's public service mission;

4.3.3. The service is incidental to the ordinary and authorized function of a campus entity, i.e., occasional sales by bookstores, food service, etc., to campus visitors;

4.3.4. The service consists of recreational, cultural, and athletic events; health services and medical treatment; public service radio and TV broadcasting; events of functions which have as their principal purposes the improvement of relations between the institutions and the general public; and sales of contributed services, if related to fund raising activities;

4.3.5. The equivalent service is not available in the local area; or

4.3.6. The service to persons not members of the campus community has been specifically authorized by the State Board of Regents.

4.5. Private Enterprise on Campus: Private enterprise entities which operate service or auxiliary units on a campus under contract with an institution are subject to this policy.

4.6. Exceptions Authorized by State Board of Regents: Exceptions to this policy may be authorized by the State Board of Regents if it determines, upon consideration and weighing of the various interests and public policies pertinent to providing the facilities, goods or services in competition with private enterprise, that the public interest favoring an exception outweighs the interest favoring denial of an exception.

Appendix B

R550, Auxiliary Enterprises Operation and Accountability²

R550-1. Purpose: To provide for institutional operation of auxiliary enterprises, identification of activities operated as auxiliary enterprises at each institution, and reporting and accountability requirements for such auxiliary enterprises.

R550-2. References

2.1. Utah Code §53B-6-102 (Standardized Systems Prescribed by the Board)

2.2. Utah Code §53B-7-101(9) (Each Institution Handles Financial Affairs Under General Supervision of the Board)

2.3. Policy and Procedures R555, Providing Facilities, Goods and Services in Competition with Private Enterprise.

R550-3. Definitions

3.1. Auxiliary Enterprises: Business enterprises or other support activities (as distinguished from primary programs of instruction, research, and public service, and from organized activities and intercollegiate athletics) the primary purpose of which is to provide specified services to students, faculty, staff or guests of the institution. All housing, food service, and college store activities in any institution are to be classified and managed as auxiliary enterprises. Other activities which serve primarily individuals (as distinguished from internal departments of the institution) and operate on an essentially self-supporting basis, also should be classified and managed as auxiliary enterprises.

3.2. Essentially Self-Supporting: Means receiving revenues (fees for services, sales, dedicated general fees, contributions, and investment income) to cover all or most of the direct and indirect operating expenses, assignable indirect costs, debt service and capital expenditures for the activity.

R550-4. General Policy

4.1. Support to Education, Research and Public Service: Auxiliary enterprises are operated as essential elements in support of the education, research and public service programs of the institutions. They are to be operated at a level of quality sufficient to support the objectives of the primary programs. Direct charges for services are to be sufficient to enable the auxiliary enterprises to operate on an essentially self-supporting basis whenever possible. Services provided by auxiliary enterprises may be incidentally available to members of the general public but are not to be marketed to the general public or outside organizations. All auxiliary enterprise organizations are required to comply with Policy R555, which regulates provision of facilities, goods and services which might be in competition with private enterprise.

² Adopted November 14, 1986, amended January 24, 1997 and March 18, 2005

4.2. Limitations of R555: The Board recognizes that Policy R555 limits the ability of institutional auxiliary enterprises such as book stores and food services to generate revenue from outside sources and therefore maximize revenues or to minimize charges to institutional users. In recognition of this limitation, institutions which cannot reach a total self-support level for designated auxiliary enterprise activities are permitted to provide subsidies from institutional discretionary funds or, if necessary, from other education and general funds, subject to the accounting requirements set forth below.

R550-5. Designation of Activities to be Operated as Auxiliary Enterprises

5.1. Criteria for Designation: In addition to the core activities of housing, food services, and college or university stores, institutions should propose for designation as auxiliary enterprises any other activities which meet the definitions provided above. However, the fact that an organized activity receives significant direct income is not in itself a reason for auxiliary enterprises designation unless the activity also serves primarily students, faculty, or staff members.

5.2. Designated Auxiliary Enterprises, by Institution

University of Utah

Bookstore
Food Services
Housing (Residence Halls and University Student Apartments)
Student Center (A. Ray Olpin University Union)
Golf Course
Parking and Campus Transportation Services
Jon M. Huntsman Center (Special Events Center)
Student Health Services

Utah State University

Bookstore Student Health Services
Housing Parking Terrace
Food Services University Residence Center
Student Center

Weber State University

Bookstore Student Center
Food Services Housing
Student Health Services

Southern Utah University

Bookstore Student Center
Food Services Housing

Snow College

Bookstore Student Center
Food Services Housing

Dixie College

Bookstore Student Center
Food Services Housing

College of Eastern Utah
Bookstore Student Center
Food Services Housing

Utah Valley State College
Bookstore Student Center
Food Services

Salt Lake Community College
Bookstore Student Center
Food Services

R550-6. Principles of Operation

6.1. Management: Except as may be in conflict with any provisions of this policy, institutional auxiliary enterprises are to be operated in accordance with overall management principles set forth in Chapter 3.2 of College and University Business Administration (National Association of College and University Business Officers, Washington, D.C., 1982). Institutions are expected to employ professional management for their auxiliary enterprise activities, and to provide administrative, accounting and financial management oversight of each auxiliary enterprise, through one or more senior officers designated by the President.

6.2. Working Capital: In order to render adequate service, auxiliary enterprises should have a solid financial base that includes sufficient reserves. Each auxiliary enterprise which involves sale of goods and services should have adequate working capital to support accounts receivable and necessary inventories of goods and supplies. (Where this policy conflicts with existing bond covenants, the bond covenants shall prevail.) Renewal and replacement funds for all auxiliary enterprises should be accumulated in amounts sufficient to provide for major equipment repair and replacement as well as refurbishment, renewal and replacement of physical facilities. Auxiliary enterprises are not, however, expected to accumulate fund balances in excess of requirements for working capital, renewals and replacements, and debt service. Subsidies from outside funds and then charges to users should be adjusted downward if an enterprise produces revenues in excess of this requirement.

6.3. Physical Plant Operations and Financial Accounting Services: Auxiliary enterprises budgets are to include costs of physical plant operations and accounting services directly chargeable to their operations. The cost of these support services may either be budgeted directly in the operations of the auxiliary enterprises, or budgeted as payments to the education and general departments or service enterprises providing the support services.

6.4. Charges for Other Indirect Costs: In addition to direct charges for support costs, under 6.3, auxiliary enterprises are to be charged for an appropriate share of other administrative support costs of the institution.

6.5. Level of Prices and Charges: Appropriate fees shall be charged to users of the auxiliary enterprises, including academic or administrative departments. To the extent reasonably possible, selling prices, rents, fees, admissions and other charges by each auxiliary enterprise are to be set at a level adequate to support the operating and reserve requirements of the enterprise.

R550-7. Accounting and Audit Requirements

7.1. Accounting Requirements: Each auxiliary enterprise is to use accounting systems appropriate to the type of business of program operated. Accounts for each auxiliary enterprises are to include all revenues, expenditures, and transfers relating to the enterprise, including interest on loans from other institutional or outside sources and expenditures or indirect charges for operation and maintenance of physical plant and financial accounting services and for other administrative support costs. Mandatory and non mandatory transfers out are to be specifically identified, as are all loans and all transfers in from other auxiliary enterprises and from institutional discretionary funds, other education and general funds, or other funds of the institution.

7.2. Auxiliary Enterprises Reports in the Annual Budget Process: A report of auxiliary enterprises operations, covering the completed actual year and the current budget year, is to be provided annually by each institution, as part of the regular Board of Regents budget process. The report, on forms or in a format provided by the Commissioner, is to include as a minimum, for each designated auxiliary enterprise and for the institutional auxiliary enterprises in total, the following information: (1) appropriate detail on revenues (e.g., sales and services, student fees, other income) and expenditures (e.g., costs of goods sold, direct operating expenses, charges for indirect costs); (2) identification of each specific source and amount of transfers in; (3) identification of each specific amount and recipient of transfers out; and (4) Details of any outstanding loans other than bonded indebtedness. (Bonded indebtedness is disclosed in the institution's audited financial statements.)

7.3. Audits of Auxiliary Enterprises: Internal audits of all auxiliary enterprises are to be made at appropriate intervals, as determined by the Board of Trustees and institutional administrators. Each institution's chief executive officer shall arrange for these audits, conducted by either the resident auditors or the Regents' audit staff. Each audit report will include the auditor's opinion regarding: (1) fairness of presentation of the most recent annual reports, in accordance with generally accepted auditing standards for reporting on prescribed format statements; and (2) the institution's compliance with this policy.

7.4. Annual Review of Financial Condition of Auxiliary Enterprises: The Associate Commissioner for Budget and Finance will prepare an analysis of the financial condition of auxiliary enterprises at each institution prior to January of each year, using reports submitted in the annual budget process pursuant to paragraph 7.2. The report will be submitted for review by the Finance and Facilities Committee, which may direct follow-up action and reports in any case where the financial condition of individual auxiliary enterprises, or institutional auxiliary enterprises in total, is not satisfactory.

R550-8. Oversight by institutional Board of Trustees

8.1. Review Reports and Audits, Monitor Services: The institutional Board of Trustees of each institution is responsible to review the institution's auxiliary enterprises annual reports prepared pursuant to Section 7.2, and periodic internal audits prepared pursuant to Section 7.3. The institutional boards of trustees also are responsible for monitoring both management of and quality of services provided by the institution's auxiliary enterprises.

Appendix C

Auxiliary Enterprises for State Colleges and Universities

	Bookstore	Student Center	Food Services	Student Housing	Student Health	Conference	Commuter/ Parking	Hotel	Stadium & Arena	Contract Admin	Vending
University of Utah	X	X	X	X	X	X	X	X	X	X	
Utah State University	X	X	X	X	X	X	X	X			
Weber State University	X	X	X	X	X						
Utah Valley University	X	X	X								
Salt Lake Community College	X	X	X								
Snow College	X		X	X		X					X
Southern Utah University	X	X	X	X							
Dixie State University	X	X	X	X							

Source: Utah System of Higher Education, S-8 Forms—Report of Auxiliary Enterprises Operations & Bond Reserve

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Agency Response

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June 27, 2013

Mr. John Schaff
Office of the Legislative Auditor General
W315 Utah State Capitol Complex
Salt Lake City, UT 84114-5315

Dear Mr. Schaff:

On behalf of the Utah System of Higher Education (USHE), I appreciate the opportunity to respond to the audit of "Higher Education's Competition with the Private Sector." I regret that a prior commitment will prevent me from personally attending the presentation of the report to the Legislative Audit Committee and have asked Dr. Greg Stauffer, Associate Commissioner for Planning, Finance and Facilities, to be available to answer any questions you may have.

The audit makes several recommendations to the State Board of Regents including that Regents' policy R555 (Providing Facilities, Goods and Services in Competition with Private Enterprise) be updated. I will work with USHE Presidents and present a recommendation to revise R555 to the Board for their action by the end of this year. My office and I will continue to work with USHE institutions regarding the understanding and compliance with the policy.

The audit raises several philosophical points regarding competition between higher education institutions and the private sector. I am very cognizant of the sensitivities of off-campus activities which can be perceived as competing head-to-head with private businesses. At the same time, I am also very much aware of the pressures non-state funded auxiliaries at our institutions face to earn sufficient revenue to be able to provide important services for the institution's students, faculty and staff. This is not always an easy balance to achieve.

I am confident the Legislature will consider the long-term ramifications of any policy decision based on the findings of the audit as these are complicated issues and the "law of unintended consequences" looms large. For instance, another recent legislative audit strongly encouraged institutions to increase auxiliary revenues to help offset the costs of utilities and operation and maintenance (O&M). Comparing the findings of the current audit with the recent audit on O&M helps to illustrate the difficult dilemma of USHE institutions to sustain auxiliary service revenues without direct state taxpayer support while at the same time avoiding any perception of competition with the private sector. Revenues from auxiliary services help fund many institutional expenditures which often include the construction and upkeep of housing units, campus bookstores, and student center facilities.

I appreciate the hard work and professionalism of the Office of the Legislative Auditor General and your willingness to allow USHE to respond. USHE is committed to maintaining policies that support our institutions in providing cost-effective services to students as well as ensuring proper accountability and transparency to the taxpayers of Utah. Attached to this cover letter is a detailed response to the audit recommendations.

Sincerely,



David L. Buhler
Commissioner of Higher Education

**USHE Response to the Higher Education's Competition with the Private Sector
Audit Recommendations
June 27, 2013**

The USHE respects the findings from the Legislative Audit on Competition with the Private Sector. The Commissioner's Office will review the existing policies, involve the presidents, and then make a recommendation to the Board of Regents to clarify and revise policy R 555 (Providing Facilities, Goods and Services in Competition with Private Enterprise) in light of the findings of this audit. After implementing policy changes, the Commissioner's staff will work with all USHE institutions to ensure compliance of the policies. The USHE recognizes the policy compliance issues addressed in the audit while also recognizing the demand on institutional auxiliary services (business-like enterprises) to raise needed revenues to support campus operations particularly in the student services area.

This dilemma relative to several USHE on-campus enterprises (U of U Rice-Eccles Stadium, USU University Inn, etc.) and concerns over potential competition with the private sector was addressed to some degree in the *September 2011 Legislative Audit of Higher Education Operation and Maintenance Funding* and in subsequent meetings. That audit discussed concerns related to the need to find additional Utilities and Operations & Maintenance (O&M) funding sources for campus facilities. The audit recommended that institutions needed at least to review how revenue-generating activities might contribute to meeting funding needs, in an effort to ensure the facilities are paying their appropriate share of costs. The USHE institutions therefore find themselves in the difficult balancing act of utilizing some "unaffiliated events" to generate needed revenue streams (and thereby not dilute core mission funding needs) while also being sensitive to charges of unfair competition with the private sector when these events are held. The pressure for institutions to constantly be on the lookout for additional revenue streams can at times appear to conflict with the mandate that they clearly stay away from any activities that can be perceived as competing directly with private businesses.

In regards to the recommendations, the USHE concur with the audit finding recommendations and will work to implement these over the coming year. Here are specific responses to the recommendations:

Chapter 2 Recommendations

1. We recommend that the Board of Regents provide greater oversight and enforcement of its policy pertaining to institutions of higher education competition with the private sector.

USHE Audit Response: We concur. Over the coming year we will carefully review and make necessary revisions in our policies, then work to ensure compliance.

2. We recommend that the Board of Regents update policy R555: Providing Facilities, Goods and Services in Competition with Private Enterprise.

USHE Audit Response: We concur. We will carefully review policy R555, make appropriate revisions, and then work to ensure compliance.

Chapter 3 Recommendations

1. We recommend that the Board of Regents consider providing guidance concerning “educationally related materials” and “unrelated business activities.”

USHE Audit Response: We concur. The audit showed several instances of differing interpretations in these recommended areas. For consistency, practices should align with policy.



June 21, 2013

Mr. John Schaff
Legislative Auditor General
W315 Utah State Capitol Complex
Salt Lake City, UT 84114

Dear Mr. Schaff:

Thank you for the opportunity to respond to your Performance Audit of Higher Education's Competition with the Private Sector. Our goal is to fulfill the university's mission, strengthen community ties, promote economic growth, promote our trademarks and names, and temper the financial burdens on students and their families. We are proud of the unique services our auxiliary enterprises provide the campus community, which includes students, faculty, staff, and also, alumni, sponsors, neighbors, and other interested citizens of our state.

Board of Regents Policy Should Be Updated

We agree that Board of Regents Policy R555 should be updated and look forward to working with the Regents to develop more current guidelines. Much has changed in higher education and the business community since the policy was last amended in 1997. The legislative audit staff agreed the Regents policy should be changed considering the role of auxiliary enterprises in community outreach and the need for those operations to be financially self-supporting. We will work with the Board of Regents to better articulate allowable activities that are fully consistent with this role and do not involve unfair competition with private enterprise.

Red Zone Stores Comply with R555 and Were Approved by Governing Board

In October 2010 the University's Board of Trustees approved entering into a lease agreement for a satellite Campus Store in Sandy considering that:

- Demand for U of U insignia merchandise had increased considerably due to the announcement the University was joining the PAC 12.
- There were increasing complaints from the growing fan base along the Wasatch Front that the campus bookstore location was inconvenient and private retailers didn't offer the variety and selections of products our fans wanted. Private retailers offered a limited and only seasonal selection of Utah insignia apparel and merchandise and didn't come close to meeting the need.

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Because the private sector does not provide the service or meet the demand for Utah insignia merchandise, we decided to reach our community through satellite stores, consistent with Policy R555 and the practice of many peer institutions. Our intent was not to increase market share, but rather to preserve a share of an expanding market by offering more convenient locations for alumni, community fans, students and prospective students.

Three years after the Sandy location was established, our market share remains approximately what it was then and private businesses continue to offer a limited selection of products on a seasonal basis. The Campus Stores Red Zones carry a wider selection of sizes, styles, and gift items year-round (5,000 SKU's of insignia merchandise per the Spring 2013 *Licensing Retail Impact Summary*). By comparison the next highest retailer is Scheels, which offers only 2,000 SKU's.

Red Zone Stores Bear the Same Costs and Do Not Undercut Private Retailer Pricing

The Utah Red Zones in Sandy, South Jordan, and Layton bear the costs that any other retail operation would; including, rent, CAM charges, costs of goods sold, and personnel. Goods are not offered at a discounted rate when compared to other retailers providing a more limited selection of insignia apparel. All property taxes are included in the rent charges and all sales tax generated is returned to the State as with any private retailer.

The U of U Trademarks and Licensing Program Supports and Promotes Private Enterprise

The University of Utah's Trademarks & Licensing department actively works with local vendors and retailers to encourage private sector production and sale of Utah insignia merchandise. We regularly partner with the private sector on marketing campaigns and promotions, and continually work to channel as much product as possible through private sector outlets. Despite our best efforts to support marketing, promotions, and acting as a liaison between licensed vendors and retailers, many private retail outlets choose to carry a limited selection only during football season.

Red Zone Stores Provide Student Training, Employment, and Discounted Textbooks

More than two-thirds of the approximately 170 University Campus Store employees are students, including all part-time employees of the store. This applies to Utah Red Zone stores. The Stores conduct a thriving student management training program, in which student employees fulfill educational training requirements in retail operation, management, accounting and human resources. The student employee can directly apply what he or she is learning in real-world management scenarios as they work in the Campus store or Red Zone stores. In addition, an Employee Textbook Incentive Plan enables student employees to borrow rather than buy their textbooks, saving each student approximately \$500 per semester. Both programs have been very successful.

Auxiliary Enterprises Are Required To Be Self-Supporting

In a recent audit by the Legislative Auditor of the operations and maintenance (O&M) expenses of auxiliary enterprises at various institutions of higher education, the findings correctly emphasized the requirement that such auxiliaries be self-supporting and that they not be subsidized from State tax dollars or otherwise by the college or university. The University of Utah has worked hard to comply with this requirement. To maintain operations, it is critical that revenues be sufficient to cover all expenses. This was recognized in the legislative audit which directed institutions to increase auxiliary revenues. The University has been extremely careful to work toward increasing its auxiliary revenues while at the same time not creating "unfair" competition.

Specifically, the "Bookstore" now referred to as the University Campus Store is recognized in R550 as an auxiliary enterprise and is required to be self-supporting. The net revenues from each

store are returned to the institution to support the auxiliary enterprise system as outlined in Utah Board of Regents policy R550. Utah Red Zones are not operated with any subsidy from state funds, student tuition or fees. The ability for the Campus Store to remain self-supporting has relied heavily on the sale of insignia merchandise to supplement the declining revenues in textbooks and general books as technology has replaced some of the hard copy textbook market. This trend is noticeable across the country in higher education. It has and continues to seem reasonable that the institution be able to promote, profit from and protect its own trademarks and names to help fund auxiliary programs where operating costs like utilities and personnel benefits have increased dramatically. (The Campus Store still plays a vital role on the University campus and thus needs to survive financially.)

University-Operated Insignia Stores Are Common in the PAC-12, Neighboring States, and States Cited by the Auditor

Membership in the PAC-12 has elevated the University of Utah trademarks and names to more of a household brand, rather than being associated solely with athletic programs. To support this change in demand the University has opened three off-campus stores. Five other PAC-12 institutions operate stores similar to the Utah Red Zones:

<u>Institution</u>	<u>Number of Locations</u>
Arizona	5
Oregon	5
UCLA	1
USC	2
Washington	5

Institutions in Nevada and Idaho also own or operate insignia merchandise outlets. There are institutionally owned or operated outlet stores in three states (Arizona, Washington, and Iowa) cited by the auditor as states where statute restricts competition with the private sector.

Stadium Tower Events Strengthen Ties With the University Community

To attract quality students and faculty, the University must continually strive to strengthen ties with its broader community, which includes students, faculty, staff, alumni, sponsors, neighbors, and other interested citizens. This is an important reason we offer Stadium Tower facilities for meetings, banquets, and receptions. These events provide access to a unique venue overlooking the Salt Lake Valley. They also provide modest revenues that are sorely needed to defray operating costs, including substantial utility costs. Generating revenue by opening up these facilities to those who choose to use them allows the University to continue the upkeep and maintenance on these large facilities thus reducing dependence on any tax base support or other funds that may detract from providing excellent academics.

The University Complies Fully With IRS Regulations

The University of Utah fully supports accurate reporting of all taxable revenue as well as the proper reporting of related expenses associated with its unrelated business income tax filings. We have taken a conservative approach to reporting unrelated business income to the IRS and comply with all applicable federal and state statutes, regulations, and judicial authority.

Again, thank you for the opportunity to provide this information. Our responses to your specific recommendations are shown in italics below.

1. "We recommend that the Legislature consider providing statutory guidance that addresses higher education competition with the private sector."

We will certainly comply with any statutory guidance the Legislature might provide. We hope that any such guidance would not damage the University's ability to build and strengthen ties with its prospective students, alumni, prospective donors and athletics fans. The unfortunate effect of undue restrictions would be to place greater financial burdens on students and their families.

2. "We recommend that the Board of Regents should provide greater oversight and enforcement of its policy pertaining to institutions of higher education competition with the private sector."

The University welcomes any additional oversight and policy enforcement, and will comply with any new requirements.

3. "We recommend that the Board of Regents should update policy R555: Providing Facilities, Goods and Services in Competition with Private Enterprise."

We agree that the policy should be updated.

4. "We recommend that the Legislature consider clarifying sales tax policy related to sales by higher education institutions."

The University has fully complied with existing statutes and will comply with any changes made by the Legislature.

5. "We recommend that the Board of Regents consider providing guidance concerning "educationally related materials" and "unrelated business activities".

We welcome any guidance that might be provided by the Board of Regents. Since tax laws are often complex and their application requires analysis of individual facts and circumstances, we believe such guidance would necessarily be general and emphasize each institution's responsibility to accurately assess its circumstances and fully comply with the law.

Sincerely,



Arnold B. Combe
Vice President

cc: David W. Pershing
David L. Buhler
Gregory L. Stauffer
Jason P. Perry
Gordon Wilson
Darren Marshall

June 28, 2013

Mr. John Schaff
Office of the Legislative Auditor General
W315 Utah State Capitol Complex
Salt Lake City, UT 84114-5315

Dear Mr. Schaff:

Thank you for the opportunity to respond to the Legislative Audit regarding Higher Education's Competition with the Private Sector.

We appreciate the efforts and hard work of the Office of the Legislative Auditor General and the manner in which the auditors worked with our staff to gather data.

We recognize that the private sector provides significant contributions to the campus as well as the community. We appreciate the importance of private business to the economy and state revenues. We also recognize the benefit educational institutions provide to the economy and tax payers in general.

In developing statutory policy it is hoped that long-term ramifications will be considered and additional research provided to fully understand the complicated and delicate balance that must be achieved between services provided by higher education and the private sector.

Utah State University recognizes the importance of adherence to Regents Policy and we have provided additional training to all auxiliary leaders to ensure compliance with policy R555: Providing Facilities, Goods and Services in Competition with Private Enterprise.

Attached is our response to the Audit.

Sincerely,



David T. Cowley
Vice President
for Business and Finance

**Utah State University's Response to the Higher Education's Competition with the Private Sector Audit
Recommendations
June 28, 2013**

Utah State University respects the findings of the Performance Audit of Higher Education's Competition with the Private Sector. Our auxiliary units have reviewed Board of Regents Policy R555 and will continue to work to ensure compliance with this policy.

We recognize that the private sector provides significant contributions to the campus as well as the community. We appreciate the importance of private business to the economy and state revenues. We also recognize the benefit educational institutions provide to the economy and tax payers in general.

The Audit makes several recommendations which could have a long-term impact on auxiliary services.

Chapter 2 Recommendations:

- *We recommend that the Legislature consider providing statutory policy guidance that addresses higher education competition with the private sector.*
 - We feel it is important that the legislature consider long-term implications of any decision based on the findings of the audit. Auxiliary units are essentially self-supporting enterprises and must cover all direct and indirect operating expenses, assignable indirect costs, debt service, and capital expenditures (Regent Policy R550). The University Inn operates on a self-support basis.
 - The University Inn and Conference Center was built in 1981 and has been providing service to the campus community since that time. They have also provided some services to the local area particularly when large community events overflow is needed. At the same time, the private sector has benefited from affiliated campus events. Some events are provided on campus because the equivalent service is not available in the local community.
 - Since the University Inn and Conference Center was built, several local enterprises have been established and compete for campus related business.
 - In recommending any statutory policy guidance we feel it is important to research the overall benefits/affects to the tax-payers of the state of Utah. Research may find that the State and taxpayers in general, benefit more from appropriate and efficiently run auxiliary units. It may further define the line that should be appropriately drawn for the greatest benefit.
- *We recommend that the Board of Regents provide greater oversight and enforcement of its policy pertaining to institutions of higher education competition with the private sector.*
 - Utah State University recognizes the importance of adherence to policy and we have provided additional training to all auxiliary leaders to ensure compliance with policy R555: Providing Facilities, Goods and Services in Competition with Private Enterprise.
- *We recommend that the Board of Regents update policy R555: Providing Facilities, Goods and Services in Competition with Private Enterprise.*
 - We concur and look forward to providing feedback and data as requested by the State Board of Regents.